Supreme Court, U.S.
FILED
MAR 1 1996
CLERK

(9)

No. 95-860

In The
Supreme Court of the United States
October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

On Writ Of Certiorari To
The California Supreme Court

AMICUS CURIAE BRIEF OF THE COMMONWEALTH OF MASSACHUSETTS AND THE STATES OF ARKANSAS, CONNECTICUT, FLORIDA, HAWAII, INDIANA, IOWA, KENTUCKY, MAINE, MARYLAND, MICHIGAN, MINNESOTA, MISSISSIPPI, NEW HAMPSHIRE, NEW JERSEY, NEW MEXICO, NORTH CAROLINA, NORTH DAKOTA, RHODE ISLAND, SOUTH CAROLINA, TENNESSEE, TEXAS, VERMONT, WASHINGTON, WEST VIRGINIA AND DISTRICT OF COLUMBIA IN SUPPORT OF PETITIONER

SCOTT HARSHBARGER
Attorney General
of Massachusetts

ERNEST L. SARASON, JR.
(Counsel of Record)
Assistant Attorney General
One Ashburton Place, 19th Floor
Boston, Massachusetts 02108
(617) 727-2200

(Additional Counsel On Inside Cover)

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

95PM

WINSTON BRYANT
Attorney General
of Arkansas

RICHARD BLUMENTHAL
Attorney General
of Connecticut

CHARLES F.C. RUFF
Corporation Counsel
of District of Columbia

ROBERT A. BUTTERWORTH
Attorney General
of Florida

JO ANN UCHIDA
Executive Director
State of Hawaii
Office of Consumer
Protection

PAMELA F. CARTER
Attorney General
of Indiana

THOMAS J. MILLER
Attorney General
of Iowa

A.B. CHANDLER
Attorney General
of Kentucky

ANDREW KETTERER
Attorney General
of Maine

J. JOSEPH CURRAN, JR.
Attorney General
of Maryland

Frank J. Kelley
Attorney General
of Michigan

HUBERT H. HUMPHREY III
Attorney General
of Minnesota

MIKE MOORE
Attorney General
of Mississippi

JEFFREY R. HOWARD
Attorney General
of New Hampshire

DEBORAH T. PORITZ
Attorney General
of New Jersey

TOM UDALL
Attorney General
of New Mexico

MICHAEL F. EASLEY
Attorney General
of North Carolina

HEIDI HEITKAMP
Attorney General
of North Dakota

JEFFREY B. PINE
Attorney General
of Rhode Island

PHILIP S. PORTER
Administrator
State of South Carolina
Department of Consumer
Affairs

CHARLES W. BURSON
Attorney General
of Tennessee

DAN MORALES
Attorney General
of Texas

JEFFREY L. AMESTOY
Attorney General
of Vermont

CHRISTINE GREGOIRE
Attorney General
of Washington

DARRELL V. McGRAW, JR.
Attorney General
of West Virginia

TABLE OF CONTENTS

TABLE OF CONTENTS – Continued

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES – Continued

Page

TABLE OF AUTHORITIES – Continued

Page

Federal Statutes and Legislative Resources

State Statutes

TABLE OF AUTHORITIES – Continued

STATEMENT OF INTEREST

The *amici curiae* Commonwealth of Massachusetts and the states of Arkansas, Connecticut, Florida, Indiana, Iowa, Kentucky, Maine, Maryland, Michigan, Minnesota, Mississippi, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Rhode Island, Tennessee, Texas, Vermont, Washington, and West Virginia through their Attorneys General, the District of Columbia through its Corporation Counsel, South Carolina's Department of Consumer Affairs through its Administrator, and Hawaii's Office of Consumer Protection through its Executive Director,[1] support petitioner Smiley's position that federal laws do not preempt California laws limiting excessive late payment penalties in credit card transactions. Preemption of these California laws will impede amici's authority to enforce their laws regulating credit card delinquency and late charges against out-of-state national banks.

---

[1] The actual participants in this Amicus Curiae Brief are listed on the signature page. Of the 26 States participating, 23 are represented by the Attorney General of the state. Hawaii is represented by the Office of Consumer Protection which, while not part of the state Attorney General's Office, is statutorily authorized to undertake consumer protection functions, including legal representation of the state and enforcement of that state's consumer protection laws. The District of Columbia is represented by its Corporation Counsel. South Carolina is represented by its Department of Consumer Affairs which administers, enforces and interprets the South Carolina Consumer Protection Code which regulates late charges, overlimit charges, other default charges and debt collection practices in South Carolina. For the sake of simplicity, amici will hereafter be referred to as the "Attorneys General" or "States."

The Amici states have a great interest in this case. This Court's interpretation of the scope of the preemption of Section 30 of the National Bank Act, codified as 12 U.S.C. §§ 85 and 86, will have a profound impact on their protection of their citizens. This Court's decision will determine whether the Attorneys General may enforce state laws that limit excessive penalty charges and other non-interest terms in credit transactions entered into by their residents.

As the chief law enforcement officers of their states, the amici wish to emphasize their view, based on long-standing principles of statutory and constitutional interpretation, that acts of Congress which do not explicitly preempt state laws must not be read more broadly than Congress intended. This is of particular concern in a case such as this one where the state laws are based on a state's traditional police powers to protect consumers in credit transactions.

Consumer protection and consumer credit are traditional and critical areas of state concern. Amici states have established comprehensive regulatory systems to ensure fairness in the relationship between consumer borrowers and their creditors. These laws reflect each state's own assessment of how best to balance protecting consumers with providing creditors sufficient incentive to lend profitably to their residents.

SUMMARY OF ARGUMENT

The lower court's majority decision destroys a state's ability to enforce laws regulating late charges in consumer credit transactions. The decision also places in doubt the validity of every state's consumer credit laws by interpreting "interest" expansively for purposes of preemption analysis. This unwarranted intrusion into substantive state consumer credit policy misreads both the language and history of the federal statute at issue and the fundamental premise that a state's historic police powers can be negated only with a clear mandate from Congress.

The lower court's decision also undermines this country's dual banking system which has been one of the most significant characteristics of American banking since the National Bank Act was passed in 1864. Historically, Congress has deferred to the interests of the states in the regulation of national banks as to all matters except those essential to their role as federal instrumentalities.

Application of the decision's preemption analysis will permit a national bank to use the law of its home state to override the consumer protection legislation of California and all other states under the guise of federal preemption. Amici submit that Congress never intended this result.

ARGUMENT

I. THE LOWER COURT'S DECISION IMPROPERLY LIMITS STATES' POLICE POWERS AND WILL SERIOUSLY ERODE STATE CONSUMER CREDIT LAWS.

A. *Smiley* Improperly Elevates South Dakota Law, Not Federal Law, On Late Payment Penalties Above The Laws Of Every Other State, Regardless Of Each State's Distinct Legislative Decisions.

California prohibits the assessment of excessive late payment penalty charges on credit card accounts when consumers are delinquent in making payments.[2] These charges, however, are permitted in South Dakota. Citibank, located in South Dakota, imposes such charges on California residents. Citibank claimed, as the basis for its authority, 12 U.S.C. § 85 which, under certain circumstances, preempts state restrictions on interest rates. Respondent also relied on *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978),

[2] Consumer protection is a traditional and important component of the police power of the states. *Griffith v. Connecticut*, 218 U.S. 563, 568-569 (1910); *California v. ARC America Corp.*, 490 U.S. 93, 101 (1989). Typical areas of state consumer credit regulation include requirements of truthful advertising, restrictions or prohibitions on automatic wage assignments or authorizations to confess judgment, limitations on security interests and restrictions on debt collection charges and practices. The need for state regulation in this area has long been judicially acknowledged. *See Aldens, Inc. v. Packel*, 524 F.2d 38 (3rd Cir. 1975), *cert. denied*, 425 U.S. 943 (1976); *Aldens, Inc. v. Miller*, 610 F.2d 538 (8th Cir. 1979), *cert. denied*, 446 U.S. 919 (1980).

as authority to export these charges throughout the country.

In order to override California law limiting excessive late payment penalty charges, the *Smiley* majority used a flawed preemption analysis to define the term "interest" in § 85 expansively to include late payment penalty charges.[3] Proceeding on this premise, shown below to be incorrect, the majority in *Smiley* incorrectly concluded that California law is superseded because the legislature of South Dakota permits the imposition of unlimited late payment penalty charges in consumer credit transactions.[4]

The result of the lower court's majority decision will be to enshrine South Dakota's policy of deregulation as a nationwide policy, regardless of other states' laws to the contrary.

[3] "Late payment charges exacted by credit card issuing banks totaled almost $2 billion in 1992, according to one industry source. (Credit Card News (Apr. 1, 1994) at p.2)." *Smiley* at Pet.App. 62 (Arabian, J., dissenting).

[4] South Dakota has legislatively expanded the definition of "interest" to be "compensation allowed by law for the use, or forbearance, or detention of money or its equivalent, including without limitation, points, loan origination fees, credit service or carrying charges, charges for unanticipated late payments, and any other charges, direct or indirect, as an incident to or as a condition of the extension of credit." S.D. Codified Laws Ann. § 54-3-1 (1990).

B. *Smiley's* Holding Will Reach Beyond Laws Limiting Late Payment Penalty Charges To Eviscerate All State Consumer Credit Laws.

Although this case is limited to consideration of late payment penalty charges, national banks elsewhere, using *Marquette* as a lever, have attempted to push the preemptive force of § 85 to virtually all terms of credit transactions with consumers. For example, at least one national bank has argued that state laws limiting collection costs and attorney fees following default are preempted.[5] To support this position this bank has incorporated the following term in its credit card agreement:

> All terms and conditions of this Agreement (including the change of terms provision, the applicable law provision, and the finance charge, late charge, returned check charge, and research charge provisions) are deemed to be interest under this Agreement and material to the determination of the finance charge.[6]

---

[5] *State of Wisconsin v. Ameritech Corporation, et al.*, Dane County Circuit Court Case No. 92CV1013 (1995) (complaint dismissed), Dst. IV, WI Ct. of Appeals, Case No. 95-3426 (appeal stayed pending decision in this matter). *See also Citibank (South Dakota), N.A. v. Thomas J. Miller as Attorney General of the State of Iowa*, C.A. 88-258-E (S.D. Iowa 1988); *State of Iowa v. Citibank (South Dakota)*, CE 029-16973 (Iowa District Court for Polk County, 1988). These cases were settled in November, 1989; no judicial decision on the merits was reached.

[6] This credit card agreement is part of the record in *State of Wisconsin v. Ameritech Corporation, et al.*, Wis. Ct. Appeals, Dst. IV, Case No. 95-3426, (R. 60, p. 4).

If this Court upholds *Smiley* and confirms the exportation theory promoted by some national banks, the states' legislative ability to balance consumers' interests with lenders' interests will be severely curtailed.

Lenders doing business in states with strong consumer protection measures will be at a competitive disadvantage against financing sources based in states which have forsaken consumer protection in order to attract banking interests.[7] National banks, located in states responsive to banking interests, eventually will dominate not only the credit card industry, but all credit markets.[8] The states that provide a greater measure of consumer protection will be confronted with the unenviable choice of eliminating these public protection provisions so that

---

[7] Although the statutory basis for interest rate exportation is more than one hundred years old, this court first considered the issue in *Marquette*. Following that decision, several states chose to eliminate consumer safeguards in credit transactions to attract national banks. Ginsburg, *Interstate Banking*, 9 Hofstra L. Rev. 1133, 1370 (1981); Burgess and Ciolfi, *Exportation or Exploitation? A State Regulator's View of Interstate Credit Card Transactions*, 42 Bus. Law 929, 933-34, 939 (1987). A few states' efforts to attract credit card issuers from other states have been successful. "Small States Teach a Big Banking Lesson," *Chicago Fed. Letter*, No. 10 (June 1986). Today, of the top ten credit card issuers, six are located in Delaware, while the respondent, the single largest issuer of Visa cards and Mastercards, is in South Dakota.

[8] In states with consumer credit laws in place, local merchants, such as appliance stores and car dealers, already offer financing from institutions located in states where consumer credit has been deregulated. *See Wiseman v. State Bank and Trust*, 854 S.W. 2d 725 (Ark. 1993) (interest rate for motor vehicle loan determined by law where bank is located).

local creditors may compete with out-of-state creditors or watching the local financing sources move elsewhere.[9]

C. The Decision Below Will Thwart State Efforts To Formulate And Enforce Nondiscriminatory Consumer Credit Laws.

It is appropriate for each state to define as a matter of policy and law consumer credit terms for transactions within its borders. States such as Delaware and South Dakota have the undisputed right to deregulate rates for their own citizens.[10] However, every state's right to set standards for fair practices in the consumer credit area within its respective borders will be curtailed if the decision below is upheld.

"Because credit has become a way of life for consumers, and their need for protection in that area is great, the most important protective efforts in the field of consumer protection in recent years relate to consumer credit

---

[9] *See, e.g.*, the Massachusetts Legislature's 1993 amendment allowing credit card late charges of up to $10.00 in place of its previous prohibition of such late charges, after the First Circuit allowed the preemption of that prohibition in *Greenwood Trust Co. v. Commonwealth*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 506 U.S. 1052 (1993). Mass. Gen. Laws Ann. c. 140, § 114B as amended by 1993 Mass. Acts Chapter 151, § 43. The Wisconsin Legislature is considering a proposal to eliminate limits on late payment penalties, over-the-limit fees and other non-interest rate charges in the event this Court determines that late charges are "interest" under § 85. Wisconsin Senate Bill 505 (1996).

[10] Indeed, the *Smiley* court seems to have substituted its policy judgments for those of the California legislature. *See* discussion at Pet. App. 35 (e.g. "As a general matter at least, late payment has no social utility").

protection." 17 Am. Jur. 2d, *Consumer and Borrower Protection* § 1 (1990). State consumer credit laws reflect the now familiar differences between commercial transactions and consumer transactions.[11] Commercial transactions presumably involve two knowledgeable parties. One party does not rely on the other party for fairness or knowledge. Terms of a commercial agreement are usually understood, even if not expressly bargained for by the parties. The parties to a commercial transaction customarily have comparable economic positions or interests at stake, or can select their respective bargaining position in the marketplace.

On the other hand, consumer transactions are for personal, not business, use. Consumers frequently lack experience from repeated transactions and have a more limited knowledge of the marketplace than the seller. Most often, contractual documents are not read, much less bargained for, by consumers.

Under the lower court's ruling, consumers subjected to unfair or illegal credit and collection practices by an out-of-state national bank will have no recourse to their state consumer protection authorities.[12] These officials will be precluded from enforcing consumer credit laws

---

[11] For example, *see* Crandall, *The Wisconsin Consumer Act: Wisconsin Consumer Credit Laws Before and After*, 73 Wis. L. Rev. 334, 357 (1974).

[12] Courts have ruled that national banks have engaged in improper practices and have taken advantage of customers. *See Beasley v. Wells Fargo Bank*, 1 Cal. Rptr. 2d 446 (Ct. App. 1st Dist. 1991); *Garrett v. Coast & Southern Fed. Sav. & Loan Ass'n*, 108 Cal. Rptr. 845, 511 P.2d 1197 (1973).

against out-of-state national banks. Further, consumers will not be able to pursue private statutory or common law remedies. Moreover, consumer protection authorities in the state where the bank is located may be less motivated to take action against a local national bank based on complaints from consumers in another state.

States have expressly extended the territorial application of their consumer credit laws to ensure evenhanded coverage of all credit offers made to consumers within their borders. These efforts have included statutory invalidation of choice of law contract terms that provide that the law of a foreign state controls a consumer credit transaction.[13] As the drafters of the Uniform Consumer Credit Act recognized in the mid 1960's:

> The danger that creditors may be able to induce consumers to agree that the applicable law will be that of a creditors' haven that has no effective consumer credit protection has led to invalidating choice of law agreements except where the law chosen is that of the state of the consumer's residence." Uniform Consumer Credit Code [1968 Act], Comment § 1.201, 7 U.L.A. 595, 619.

State residents are entitled to and reasonably expect the protection of their own state's laws. Consumers should not be subject to the non-interest laws of other states. While the market arguably regulates the "interest rates" offered across state lines, it does not regulate back-

[13] For example, *see* Sec. 421.201(10)(a), Wis. Stats.; *Aldens, Inc. v. LaFollette*, 552 F.2d 745 (7th Cir. 1977), *cert. denied*, 434 U.S. 880 (1977).

end late fees or other penalties after a loan default. Banks usually do not compete on the basis of penalties for the contractual breach, nor are consumers particularly sensitive to those penalties when choosing credit cards. Because such penalties, like late fees, can be more oppressive than market-based "interest," the resident states have a superior interest in limiting such charges when compared to the interest of a bank's home state.

II. *SMILEY'S* UNWARRANTED INTRUSION INTO SUBSTANTIVE STATE CONSUMER CREDIT POLICY OVERLOOKS THE FUNDAMENTAL PREMISE THAT A STATE'S POLICE POWER CAN BE NEGATED ONLY WITH A CLEAR MANDATE FROM CONGRESS AND THE LANGUAGE AND HISTORY OF THE FEDERAL STATUTE AT ISSUE.

A. *Smiley* Refers To But Does Not Apply The Preemption Principles Developed By This Court.

"Consideration of issues arising under the Supremacy Clause 'start[s] with the assumption that the historic police powers of the States [are] not to be superseded by . . . Federal Act unless that [is] the clear and manifest purposes of Congress.' " *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992), citing *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). The requirement that preemption be found only when there is clear evidence of Congressional intent applies to consideration of both express statutory preemption and implied conflict preemption. *Freightliner Corp. v. Myrick*, 115 S.Ct. 1483, 1488 (1995).

This axiom is essential to the states. Appropriate deference to state laws helps ensure that Congress does

not supersede state legislative enactments except through deliberate action. Principles of federalism demand no less.[14] By finding that state laws may be preempted by stretching the definition of a federal law, the majority opinion below is incompatible with this Court's preemption decisions.[15]

The majority in *Smiley* did not recognize the clear meaning and import of this Court's preemption decisions. The California Supreme Court initially reviewed the language of § 85 and concluded that the term "interest" was not defined.[16] Having done so, it should then have applied the standard set out in *Cipollone*: where there is

---

[14] As Chief Justice Rehnquist has emphasized: "Unless the requisite pre-emptive intent is abundantly clear, we should hesitate to invalidate state and local legislation for the added reason that 'the state is powerless to remove the ill effects of our decision, while the national government, which has the ultimate power, remains free to remove the burden.' " *City of Burbank v. Lockheed Air Terminal, Inc.*, 411 U.S. 624, 643 (1973) (Rehnquist, J., dissenting) (quoting *Penn Dairies, Inc. v. Milk Control Comm'n*, 318 U.S. 261, 275 (1943)).

[15] As Justice O'Connor has explained, the right to preempt state law under the Supremacy Clause is an extraordinary power in a federalist system. The use of this power will not be implied unless Congress has made its intention clear. To depart from this standard would place in jeopardy the federalist system of joint sovereigns. *Gregory v. Ashcroft*, 111 S. Ct. 2395, 2399 (1991).

[16] The First Circuit Court of Appeals made the same error in *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 506 U.S. 1052 (1993), by continuing its preemption analysis despite finding that " . . . DIDA's text and legislative history are, at bottom, inconclusive." *Id.* at 828.

no clear evidence of preemptive intent, a finding of federal preemption is foreclosed. This approach would have properly limited § 85 to its plain meaning – numerical interest rates. Instead, without conducting any preemption analysis whatsoever, the majority relied on *Marquette* for the proposition that § 85 preempts state laws relating to "interest," and framed the issue as one centering on the *scope* of preemption.[17] At this point the *Smiley* majority abandoned preemption principles and looked to secondary sources to define interest broadly to encompass any payments obtained from a borrower. Ultimately, the majority concluded that the power of South Dakota to dictate non-interest rate terms for California was "implicit" in the word "interest" as meant by the framers of the National Bank Act.[18] Both the plain meaning of the statute and its legislative history were ignored.

By forging ahead with an analysis of secondary sources while overlooking the purpose of § 85 and its

---

[17] In a separate opinion in *Cipollone* joined by Justices Kennedy and Souter, Justice Blackmun concurred with the majority and noted: "The principles of federalism and respect for state sovereignty that underlie the Court's reluctance to find pre-emption where Congress has not spoken directly to the issue apply with equal force where Congress has spoken, though ambiguously. In such cases, the question is not *whether* Congress intended to pre-empt state regulation, but to what *extent*. We do not, absent unambiguous evidence, infer a scope of pre-emption beyond that which clearly is mandated by Congress' language." *Cipollone*, 505 U.S. at 533. (Emphasis in the original.)

[18] "Had Congress intended to limit protection, it would doubtless have made itself plain. It did not. Its silence is especially deafening. . . . " *Smiley* at Pet. App. 24.

legislative history, the decision misapplied important preemption principles. The *Smiley* majority turned the *Cipollone* standard on its head by reasoning that because Congress did not speak plainly to preemption, it must have intended or implied limitless preemption.

B. Section 30 Was Enacted In 1864 As A Usury Statute That Prescribed The Rate Of Interest National Banks Are Permitted To Charge. The Scope Of Preemption Must Be Interpreted As Narrowly As Is Consistent With Its Plain Meaning.

The primary objective of Section 30 of the National Bank Act was to enact a federal usury law for national banks. This measure, today codified as 12 U.S.C. §§ 85 and 86, prescribed an interest rate ceiling and federal remedy for usury. It also protected national banks from discriminatory state usury laws under the "most favored lender" doctrine articulated by this Court in *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409 (1874).

Discriminatory state usury laws are not at issue in this case. The explicit language of this statute does not speak to late payment penalty charges or credit terms other than the rate of interest. The majority in *Smiley* conceded correctly that language addressing late payment penalties or delinquency charges was not present in the statutory scheme. Further, the legislative history reveals no evidence of Congressional intent to displace

state law regarding penalty charges or payments other than for interest.[19]

The term "interest" in § 85 must be given federal definition, independent of unique state definitions. This principle was recognized by this Court in *Tiffany* which held that "interest" must "receive a strict, that is literal construction" to avoid subjecting banks to double interest penalties under the Act. *Id.* at 410. While maximum *rates* of interest would vary among the states because of different state interest rate ceiling laws, the *meaning* of interest rate for national banks would be uniform across all the states. *See National Bank v. Johnson*, 104 U.S. 271, 277 (1881) (§ 85 of the National Bank Act federalizes the "rate" of interest, not the character of bank contracts).

In setting limits on rates of interest charged by national banks under the National Bank Act, Congress showed great deference to the states: the usury ceiling for a national bank would be the usury ceiling of that bank's home state. Respondent's attempt to use this provision of the Act, more than one hundred years after its passage, to engage in wholesale exportation of South Dakota's caveat emptor regime, thereby eviscerating the non-usury consumer protection laws of all the other states, turns upside down Congressional intent and violates Congressional deference.

---

[19] Justice Arabian's dissent details the historical record regarding the enactment of the National Bank Act by the 38th Congress in 1864. The majority does not dispute this analysis, but takes the term "interest" out of its statutory context and looks to secondary sources as a basis for its expansive meaning.

The *Smiley* majority failed to point to evidence that by enacting a federal usury statute, Congress intended to preempt charges that were not customarily considered in determining compliance with these laws. The majority avoided historical authority and reasoning advanced in the dissenting opinions by suggesting that such authorities concern "lawful interest" in contrast to the more general concept of "interest" (*Smiley*, Pet.App. 20, n.8). However, this distinction would have made no sense to members of Congress in 1864. Today, this has no greater persuasive significance.

Section 85 preempts state usury laws but nothing more. In the 1860's, late payment penalties were not included in determining the rate of interest.[20] Therefore, late payment penalties were irrelevant to usury analyses, imposition of those penalties did not violate state usury laws, and the regulation of those penalties did not conflict with federal usury laws. Today, state laws limiting late payment penalty charges remain beyond the scope of federal preemption. The federal usury provisions of the National Bank Act look to the laws of a national bank's home state only to determine the maximum interest rate, not the laws that regulate (or more precisely, fail to regulate) late payment penalty charges.

[20] *See Gower v. Carter*, 3 Iowa 244 (1856); *Ramsey v. Morrison*, 39 N.J.L. 591 (1877); *Randall v. Home Loan & Investment Co.*, 12 N.W. 2d 915 (Wis. 1944).

C. There Is No Conflict Preemption Because State Laws Limiting Late Payment Penalties Do Not Make Compliance With § 85 Impossible Or Unduly Obstruct The Banking Business.

In the absence of express statutory preemption, conflict preemption may be implied where it is impossible to comply with both state and federal requirements, or where state law stands as an obstacle to achieving the intent of Congress. *Freightliner Corp. v. Myrick*, 115 S. Ct. 1483 (1995). As with express preemption, conflict preemption will not be found unless it is the clear intent and purpose of Congress. *CSX Transp., Inc. v. Easterwood*, 113 S. Ct. 1732, 1737 (1993).

When considering preemption under the National Bank Act, this Court has consistently and repeatedly recognized that state laws are not to be set aside simply to accommodate the commercial convenience of national banks.[21] In *National Bank v. Commonwealth*, 76 U.S. (9 Wall.) 353, 362 (1869), this Court stated:

> [National banks] are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than

[21] The *Smiley* majority suggests that these cases are inapposite because *Marquette* determined that state laws related to "interest" were preempted due to "conflict" with federal law. (*Smiley*, Pet.App. 12, n.4) However, Justice Brennan looked to the plain meaning of the statutory text to determine that the *rate of interest* was determined by the law of the state where the bank was located. *Marquette* did not hold that the preemption analysis of prior decisions under the National Bank Act was inapplicable when express terms of the Act do not conflict with state law.

> of the nation. All their contracts are governed and construed by state laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on state law. It is only when the state law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional.

This principle has been balanced with national banks' role as federal instrumentalities. State action which conflicts with or frustrates the purpose of the federal act is void. *Davis v. Elmira Savings Bank*, 161 U.S. 275, 283 (1896). Almost one hundred years ago this Court reconciled these principles in *McClellan v. Chipman*, 164 U.S. 347, 357 (1896):

> These two propositions, which are distinct, yet harmonious, practically contain a rule and an exception, the rule being the operation of general state laws upon the dealings and contracts of national banks, the exception being the cessation of the operation of such laws whenever they expressly conflict with the laws of the United States or frustrate the purpose for which the national banks were created, or impair their efficiency to discharge the duties imposed upon them by the law of the United States.

The application of these principles to this case does not evidence a clear intent to preempt state laws as held by the majority below. First, it is not impossible for national banks to comply with both § 85 and nondiscriminatory state laws limiting late payment penalty charges and other non-interest terms so as to infer congressional intent to preempt contrary state law. National banks may comply with home state interest rate limits,

while conforming to laws governing non-interest charges and other terms of the states where their customers reside.[22]

Second, the *Smiley* majority did not demonstrate that the state laws limiting late payment penalty charges frustrated the purposes of the National Bank Act or somehow prevented banks from discharging their duties under federal law.[23] The federal duties or purposes of national banks were laid out in the National Bank Act and its legislative history and include: "to establish a system of

---

[22] The majority's concern that limiting national banks to the "varying laws of the several states . . . might 'throw into confusion the complex system of modern interstate banking.' " (*Smiley*, Pet.App. 29), quoting *Marquette*, 439 U.S. at p. 312) is ill-founded. Justice Brennan was concerned about using the place of the transaction, not the customer's state of residence, as the basis for selection of the law to be applied. Moreover, sophisticated computer technology enables other interstate sellers to conform to consumer protection laws of states where customers reside. Today, creditors, other than financial entities under federal interest rate laws, operate on a national scale and extend consumer credit terms which comply with the laws of the states where the customer resides. *See Aldens, Inc. v. Packel*, 524 F.2d 38 (3d Cir. 1975), *cert. denied*, 425 U.S. 943 (1976); *Aldens, Inc. v. Miller*, 610 F.2d 538 (8th Cir. 1979), *cert. denied*, 446 U.S. 919 (1980).

[23] The *Smiley* majority suggests that an obstacle to federal policies would exist if a state were to set interest rates to unprofitably low rates, yet permit lenders other than national banks to impose high penalty charges so as to drive national banks out of business. (Pet.App. 22) However, this scenario is not realistic. It assumes, *inter alia*, that favored banks would seek out chronic delinquents (and jeopardize repayment of principal and interest) so as to maximize late payment penalties.

national banking institutions, in order to provide a uniform and secure currency for the people and facilitate the operations of the Treasury of the United States." *Mercantile Bank v. New York*, 121 U.S. 138, 154 (1887).

State laws regarding credit terms other than the rate of interest do not impede, frustrate, or incapacitate national banks from achieving these federal purposes. The *Smiley* majority does not point to a real impediment created by requiring national banks to be subject to state laws in an area traditionally reserved to the states.

Furthermore, federal intervention in the consumer credit area does not occupy the field and foreclose state involvement apart from interest rate limits under usury laws. Far from evidencing a desire to occupy the entire field of consumer credit, the federal government's intervention in this area has been cautious, limited and deliberately deferential to state laws.[24] Generally, federal provisions only preempt state law when state law either offers less protection than, or is inconsistent with, the federal law.[25]

---

[24] For example, the federal Truth-in-Lending Act, 15 U.S.C. 1601 *et seq.*, regulates consumer lending disclosures but explicitly leaves intact substantive state consumer protection laws. *See*, 15 U.S.C. sec. 1610. Similar deference to state law is demonstrated in the Equal Credit Opportunity Act, 15 U.S.C. secs. 1691-1691f (*see*, 15 U.S.C. sec. 1691d(f)), the Fair Debt Collection Practices Act, 15 U.S.C. secs. 1692-1692o (*see*, 15 U.S.C. sec. 1692n) and the Electronic Fund Transfers Act, 15 U.S.C. sec. 1693-1693r (*see*, 15 U.S.C. sec. 1693q).

[25] For example, the legislative history of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDA), 12 U.S.C.A. § 1831, is instructive to an understanding of

The test for preemption is not inconvenience, nor even a claim of financial detriment to a private institution, but whether the state laws frustrate the purpose of the federal legislation. State laws are not preempted because they may modify defendants' options in a particular state; they are preempted only if they interfere with the federal purpose behind the National Bank Act. Absent federal preemption, states, not banks, and not even national banks, determine the laws, benefits and protection afforded to their consumers.

Congress' intent with respect to the notion of interest contained in the National Bank Act. "Although the NBA [National Bank Act] was enacted 100 years earlier, the same tensions, namely parity between federal and state lenders and preservation of local usury laws, were present and these conflicting considerations generated substantial concerns surrounding the passage of the earlier banking statute. The record of Congressional debate and deliberation concerning the enactment of DIDA strongly supports the understanding that preemption of credit-card regulation under DIDA is confined to traditional numerical interest rates . . . . Thus, the fact that Congress was specifically concerned about effecting a preemption limited to numerical interest rates is significant. If we cannot attribute to legislative initiative of 15 years ago the intent to include discrete, specialized charges within a definition of interest, we cannot ascribe that expansive definition of a legislative initiative that occurred over 100 years earlier." *Sherman v. Citibank (South Dakota), N.A.*, No. A-102-94 slip op., Pet.App. 151, 160-64 (N.J. Nov. 28, 1995).

III. AGENCY INTERPRETATIONS SUPPORTING PREEMPTION UNDER § 85 ARE NOT ENTITLED TO DEFERENCE BECAUSE THEY CONTRADICT CONGRESSIONAL INTENT TO PREEMPT STATE CONSUMER CREDIT LAWS NARROWLY.

The decision below bolsters its expansive construction by reference to interpretations of the Office of Comptroller of the Currency (OCC) and its rulemaking proposal to define "interest" broadly to include almost any charge a national bank may impose upon a borrower. 60 Fed. Reg. at 11940 (March 3, 1995). Recently the OCC issued the final rule which includes such a sweeping definition of interest.[26] However, the lower court did not base its decision on these administrative actions which are entitled to neither weight nor deference.

Although the OCC rule purports to define "interest," the obvious consequence will be the wholesale preemption of state laws limiting charges not included in calculating a rate of interest imposed by out-of-state national

[26] The final text is as follows: "The term 'interest' as used in 12 U.S.C. 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports." 60 Fed. Reg. at 4869 (February 9, 1996). 12 C.F.R. § 7.4001(a).

banks.[27] However, Congress has never explicitly preempted state limitations on non-interest charges such as late charges, default charges or state limitations on charges related to collection costs, such as attorney fees.

The OCC's rulemaking attempt to preempt state laws conflicts with the spirit if not the letter of § 114 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, P.L. 103-328, Sept. 29, 1994, 108 Stats. 2338. That Act requires agencies to specify particular state banking laws which are to be administratively preempted. The OCC did not attempt in the preamble or in the text of the rule to identify those state laws, thereby depriving states of adequate notice of the potential preemptive impact of the proposed rule. Without such notice, many states may not realize that substantial portions of their versions of the Uniform Commercial Code, the Uniform Consumer Credit Code, the Retail Installment Sales Act and the common law of contracts, collections, attorney fees and penalties have been displaced by administrative fiat.

The legislative history of Riegle-Neal makes clear Congressional intent to narrowly preempt state consumer protection laws:

[27] The OCC's definition of "interest" does not apply to all transactions. In order to enable national banks located in states with fixed interest rate limits to avoid violating these usury laws – a likely result if late payment penalty fees and other charges were included as part of the interest rate – OCC's rule states that the definition is not to be used for credit extended within the state where the bank is located. 12 C.F.R. § 7.4001(c). The OCC offers no reasoned explanation for this approach.

> States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions. States have a legitimate interest in protecting the rights of their consumers, businesses, and communities . . . Congress does not intend that the Interstate Banking and Branching Efficiency Act of 1994 alter this balance and thereby weaken States' authority to protect the interests of their consumers, businesses, or communities. . . .
>
> It is of utmost concern to the Conferees that the agencies issue opinion letters and interpretive rules concluding that Federal law preempts state law regarding community reinvestment, consumer protection, fair lending, or establishment of intrastate branches *only when the agency has determined that the Federal policy interest in preemption is clear.*

H. Conf. Rep. No. 651, 103rd Cong., 2nd Sess. 53 *reprinted in* 1994 U.S.C.C.A.N. 2068, 2074 (emphasis added)

Long-standing principles of administrative law prohibit giving any weight to the OCC's actions. First, there is no explicit congressional mandate to the OCC regarding § 85 or relating to the definition of the preemptive reach of the Act. The interpretations and rule definition do not advance traditional administrative objectives or fill in the gaps of statutory coverage or explain how the comptroller will exercise discretion in the future. Cf. *Perdue v. Crocker Nat'l Bank*, 38 Cal. 3d 913, 702 P.2d 503, 523, n. 38 (Cal. 1985), *appeal dismissed*, 475 U.S. 1001 (1986).

Second, the interpretations themselves are of questionable authority as they are not based on the banking

expertise of the agency. Instead they are quasi-judicial determinations of whether state consumer protection laws are preempted by federal banking laws.

Finally, as has been shown above, the conclusion advanced by the OCC – that interest rate includes other charges – cannot be reconciled with the plain language and Congressional intent of § 85. "[A]n agency's interpretation of a statute is not entitled to deference when it goes beyond the meaning that the statute can bear . . . " *MCI Telecommunications v. AT&T*, 114 S.Ct. 2223, 2231 (1994). These recent interpretations and rulemaking are nothing more than an attempt to shore up the position of national banks in pending litigation. The courts, not an administrative agency without authorization from Congress, are the final authority on these issues of statutory construction. Administrative constructions which are contrary to clear congressional intent must be rejected. The OCC should not have attempted to accomplish indirectly what Congress only recently has refused to preempt directly.

CONCLUSION

For the above reasons, the judgment of the California Supreme Court should be reversed.

Respectfully submitted,

SCOTT HARSHBARGER
Attorney General
of Massachusetts

ERNEST L. SARASON, JR.
(Counsel of Record)
Assistant Attorney General
One Ashburton Place, 19th Floor
Boston, Massachusetts 02108
(617) 727-2200

Date: March 1, 1996